



DEPARTMENT OF THE TREASURY

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street M/C 4920 DAL  
Dallas, TX 75242

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: FEB 14, 2017

Person to Contact:

Number: **201731014**  
Release Date: 8/4/2017

Identification Number:  
Telephone Number:  
In Reply Refer to: TE/GE Review Staff

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

UIL: 501.03-00

CERTIFIED MAIL – Return Receipt Requested

Dear :

This is a Final Adverse Determination Letter that your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC) is revoked. Recognition of your exemption under IRC section 501(c)(3) is revoked effective January 1, 20XX.

Our adverse determination was made for the following reason(s):

You are a hospital organization which failed to comply with the requirements of IRC section 501(r), to conduct a community health needs assessment, adopt an implementation strategy and make it widely available to the public.

Contributions to your organization are not deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91<sup>st</sup> day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

for

Mary A Epps  
Acting Director, Exempt Organizations Examinations

**Enclosure:**

Publication 892

**Department of the Treasury**  
**Internal Revenue Service**  
**IRS Tax Exempt and Government Entities Division**  
1100 Commerce Street-MC: 4900 DAL  
Dallas, Texas 75242

**DEC 06 2016**

Date:

Taxpayer Identification Number:

Form:

Tax year(s) ended:

Person to contact / ID number:

Contact numbers:

Phone Number:

Fax Number:

Manager's name / ID number:

**Certified Mail - Return Receipt Requested**

Dear \_\_\_\_\_ :

Manager's contact number:

Phone Number:

Response due date:

**Why you are receiving this letter**

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

**What you need to do if you agree**

If you agree with our proposal, please sign the enclosed Form 6018, *Consent to Proposed Action - Section 7428*, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

**Effect of revocation status**

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

**What you need to do if you disagree with the proposed revocation**

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the



IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

**Contacting the Taxpayer Advocate Office is a taxpayer right**

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service  
Office of the Taxpayer Advocate

**For additional information**

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

for Mary A. Epps  
Acting Director, Exempt Organizations Examinations

Enclosures:  
Report of Examination  
Form 6018  
Publication 892  
Publication 3498



Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended 12/31/20XX

## ISSUE

Failure to satisfy the requirements of Internal Revenue Code (IRC) §501(r), specifically IRC §501(r)(3), conducting a Community Health Needs Assessment (CHNA) every 3 years.

## FACTS

The \_\_\_\_\_ was incorporated with the state of \_\_\_\_\_ in 19XX. It operates in \_\_\_\_\_ County which encompasses several small communities; \_\_\_\_\_, \_\_\_\_\_, and others. The \_\_\_\_\_ applied for and was granted tax exempt status under IRC §501(c)(3) shortly after incorporating. This hospital organization is also known as a “dual status” entity since it has received confirmation from the IRS that it is tax-exempt under IRC §501(c)(3). It also qualifies as a governmental unit or as an affiliate of a governmental unit as described in Revenue Procedure 95-48, 1995-2C.B. 418. The organizations’ books and records are maintained on a calendar year basis.

When the original hospital organization was incorporated it was operated by a management company and had its own board of directors. In 20XX the \_\_\_\_\_ came into difficulties while being operated by the original management company. The Board of Directors wanted to close the facility. A local \_\_\_\_\_ County governmental agency, \_\_\_\_\_, stepped in and decided that the facility should remain open. They took control over managing the \_\_\_\_\_ . \_\_\_\_\_ was established around 19XX to provide hospital care, emergency care, and clinical care to the residents of \_\_\_\_\_ County. \_\_\_\_\_ was already operating another facility-the \_\_\_\_\_ .

\_\_\_\_\_ is still in charge of the \_\_\_\_\_ and \_\_\_\_\_ hospital facilities. Both hospitals have a \_\_\_\_\_ member volunteer Board of Directors. The members are selected from the surrounding communities. The \_\_\_\_\_ board members are appointed by \_\_\_\_\_ County Commissioners. Each member serves \_\_\_\_\_ to \_\_\_\_\_ year terms. The \_\_\_\_\_ facility is known as a “Disproportionate Share Hospital” and is designated by Medicare as a “critical care access facility” for Medicare billings purposes. The \_\_\_\_\_ hospital facility is not recognized as tax-exempt under IRC §501(c)(3) and is under the prospective payment system of Medicare.

The Revenue Agent met with the following administrators during the Affordable Care Act audit for the calendar year 12/31/20XX:

- 1) \_\_\_\_\_ - current Chief Financial Officer (CFO) of both \_\_\_\_\_ and \_\_\_\_\_ facilities
- 2) \_\_\_\_\_ - Chief Executive Officer of both \_\_\_\_\_ and \_\_\_\_\_ facilities
- 3) \_\_\_\_\_ - Chief Operations Officer (COO) of the \_\_\_\_\_ facility

Each administrator stated the consulting firm National Rural Health Resource Center approached

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in 20XX. They promoted their consulting services in the area of the “Affordable Care Act” particularly with regards to Section 9007 and the additional requirements on charitable hospitals under Treasury Regulation §1.501(r). believed conducting the Community Health Needs Assessment (CHNA) was a good idea. But the project was not undertaken with the intent of complying with the Affordable Care Act.

The Community Health Needs Assessment conducted during 20XX-20XX by National Rural Health Resource Center was carried out to meet requirements of Medicare. The facility needed the CHNA report to keep their Medicare designation as a “critical care access facility” and the facility needed the CHNA report as part of Medicare’s process to attain this same designation for their facility. The CHNA report prepared by National Rural Health Center was completed and adopted by the organizations board by February 20XX.

The CHNA requirements of section IRC §501(r)(3) were effective for taxable years beginning after March 23, 20XX. The initial CHNA report for the facility should have been completed and adopted during the 20XX calendar year. The Implementation Strategy Report should have been completed and adopted by May 15, 20XX. The CHNA report was never made widely available to the public via a website. The organization claims that they did have the document available to the public in paper form but only when and if it was requested.

, Chief Executive Officer of both the and facilities, stated that they may have acted on several of the recommendations made in the Implementation Strategy Report. However, other than that, there was no separate written implementation policy ever drafted and adopted by for either of the hospital facilities they manage. No implementation strategy was ever developed as described in Treasury Regulation §1.501(r)-3(2)(c) and no implementation strategy was ever adopted by an authorized body as required by Treasury Regulation §1.501(r)-3(2).

Several times during the interview it was stated that really did not need, actually have any use for, or want their tax-exempt status under IRC §501(c)(3). They maintained that there were times that their tax-exempt status actually prevented the facility from becoming involved in some of the various Medicare reimbursement or payment arrangements. It was further stated that the tax-exempt status under IRC §501(c)(3) was only maintained in case any liabilities arose relating to the prior management company who had originally obtained this status from the Internal Revenue Service.

Finally, the administrators indicated that the , as a small rural facility, had neither the financial wherewithal nor the staffing to devote to the specific requirements of Treasury Regulation §1.501(r)-3 for conducting a proper Community Health Needs Assessment every three years.



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## LAW

Hospital organizations described as "dual status" are not required to file Form 990(s) under Revenue Procedure 95-48.

There is no provision in the Internal Revenue Code that imposes a tax on the income of governmental units. The term "governmental units" refers to the states and their political subdivisions. The income of governmental units is not generally subject to federal income taxation. However, the income of a separately organized entity, that is, an organization that is not an integral part of a state government or a political subdivision, is subject to tax unless an Internal Revenue Code exemption or exclusion applies.

The term "instrumentality" of a governmental unit does not appear in IRC §501. It is referenced, however, in the IRC sections applying the FICA and FUTA employment tax IRC §501(c)(3) exemption.

A wholly owned state or municipal entity which is separately organized and not an integral part of the state or local government itself, and which is organized and operated exclusively for purposes described in IRC §501(c)(3) may qualify for exemption from federal income tax under IRC §501(a) as an organization described in IRC §501(c)(3). Rev. Rul. 60-384, 1960-2 C.B. 172.

Per IRC §501(r)(2) - Hospital organizations to which the additional requirements of IRC §501(r) apply:

IRC §501(r)(2)(A) In general. —This subsection shall apply to:

- 1) IRC §501(r)(2)(A)(i) - an organization which operates a facility which is required by a State to be licensed, registered, or similarly recognized as a hospital, and
- 2) IRC §501(r)(2)(A)(ii) - any other organization which the Secretary determines has the provision of hospital care as its principal function or purpose constituting the basis for its exemption under subsection (c)(3) (determined without regard to this subsection).

IRC §501(r)(2)(B) - Organizations with more than 1 hospital facility. —If a hospital organization operates more than 1 hospital facility:

IRC §501(r)(2)(B)(i) - the organization shall meet the requirements of this subsection separately with respect to each such facility, and

IRC §501(r)(2)(B)(ii) the organization shall not be treated as described in subsection (c)(3) with respect to any such facility for which such requirements are not separately met.



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The Community Health Needs Assessment Requirement under IRC §501(r)

IRC §501(r)(3) Community Health Needs Assessments. —

IRC §501(r)(3)(A) In general. —An organization meets the requirements of this paragraph with respect to any taxable year only if the organization:

- 1) IRC §501(r)(3)(A)(i) has conducted a community health needs assessment which meets the requirements of subparagraph (B) in such taxable year or in either of the 2 taxable years immediately preceding such taxable year, and
- 2) IRC §501(r)(3)(A)(ii) has adopted an implementation strategy to meet the community health needs identified through such assessment.

IRC §501(r)(3)(B) Community Health Needs Assessment. —A community health needs assessment meets the requirements of this paragraph if such community health needs assessment:

- 1) IRC §501(r)(3)(B)(i) takes into account input from persons who represent the broad interests of the community served by the hospital facility, including those with special knowledge of or expertise in public health, and
- 2) IRC §501(r)(3)(B)(ii) is made widely available to the public.

Treasury Regulations §1.501(r)-2 Failures to satisfy section IRC §501(r). —

Failures to satisfy IRC §501(r). —(a) Revocation of section IRC §501(c)(3) status. —Except as otherwise provided in paragraphs (b) and (c) of this section, a hospital organization failing to meet one or more of the requirements of IRC §501(r) separately with respect to one or more hospital facilities it operates may have its section IRC §501(c)(3) status revoked as of the first day of the taxable year in which the failure occurs. In determining whether to continue to recognize the status of a hospital organization that fails to meet one or more of the requirements of IRC §501(r) with respect to one or more hospital facilities, the Commissioner will consider all relevant facts and circumstances including, but not limited to, the following:

- (1) Whether the organization has previously failed to meet the requirements of IRC §501(r), and, if so, whether the same type of failure previously occurred.
- (2) The size, scope, nature, and significance of the organization's failure(s).

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(3) In the case of an organization that operates more than one hospital facility, the number, size, and significance of the facilities that have failed to meet the requirements relative to those that have complied with these requirements.

(4) The reason for the failure(s).

(5) Whether the organization had, prior to the failure(s), established practices or procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the section 501(r) requirements.

(6) Whether the practices or procedures had been routinely followed and the failure(s) occurred through an oversight or mistake in applying them.

(7) Whether the organization has implemented safeguards that are reasonably calculated to prevent similar failures from occurring in the future.

(8) Whether the organization corrected the failure(s) as promptly after discovery as is reasonable given the nature of the failure(s).

(9) Whether the organization took the measures described in paragraphs (a)(7) and (a)(8) of this section before the Commissioner discovered the failure(s).

(b) Minor omissions and errors

(1) In general. —A hospital facility's omission of required information from a policy or report described in §1.501(r)-3 or §1.501(r)-4, or error with respect to the implementation or operational requirements described in §1.501(r)-3 through 1.501(r)-6, will not be considered a failure to meet a requirement of section 501(r) if the following conditions are satisfied:

(i) Such omission or error was minor and either inadvertent or due to reasonable cause.

(ii) The hospital facility corrects such omission or error as promptly after discovery as is reasonable given the nature of the omission or error. Such correction must include establishment (or review and, if necessary, revision) of practices or procedures (formal or informal) that are reasonably designed to promote and facilitate overall compliance with the requirements of section 501(r).

(2) Minor. —In the case of multiple omissions or errors, the omissions or errors are considered minor for purposes of this paragraph (b) only if they are minor in the aggregate.



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(3) Inadvertent. —For purposes of this paragraph (b), the fact that the same omission or error has been made and corrected previously is a factor tending to show that an omission or error is not inadvertent.

(4) Reasonable cause. —For purposes of this paragraph (b), the fact that a hospital facility has established practices or procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the section 501(r) requirements prior to the occurrence of an omission or error is a factor tending to show that the omission or error is due to reasonable cause.

(c) Excusing certain failures if hospital facility corrects and discloses. —A hospital facility's failure to meet one or more of the requirements described in §1.501(r)-3 through §1.501(r)-6 that is neither willful nor egregious shall be excused for purposes of this section if the hospital facility corrects and makes disclosure in accordance with rules set forth by revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin. For purposes of this paragraph (c), a “willful” failure includes a failure due to gross negligence, reckless disregard, or willful neglect, and an “egregious” failure includes only a very serious failure, taking into account the severity of the impact and the number of affected persons. Whether a failure is willful or egregious will be determined based on all of the facts and circumstances. A hospital facility's correction and disclosure of a failure in accordance with the relevant guidance is a factor tending to show that the failure was not willful.

## GOVERNMENT'S POSITION

It is the government's position that \_\_\_\_\_ in charge of the \_\_\_\_\_ failed to adequately meet all the requirements of §1.501(r)-3 by not completing and adopting an Implementation Strategy as required by IRC §501(r)(3)(A)(ii) and by not making the CHNA report widely available to the public as required by IRC §501(r)(3)(B)(ii). The failures noted are not minor but rather are egregious failures when reviewed in the context of IRC §501(r).

During the audit, the organization's administrators made it clear that \_\_\_\_\_ had neither the will, the financial resources, nor the staff to follow through with the CHNA process required under §1.501(r)-3 on a triannual basis. Consequently, \_\_\_\_\_'s 20XX failure to meet the requirements of §1.501(r)-3 is considered willful. Especially in light of the fact that the organization expressed on several occasions that they did not need to be exempt under IRC §501(c)(3) and that this status at times actually got in the way of their ability to be involved in various Medicare reimbursement programs.

Based on the above, Government has concluded that the IRC §501(c)(3) exempt status of \_\_\_\_\_ should be revoked effective back to January of 20XX.



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